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40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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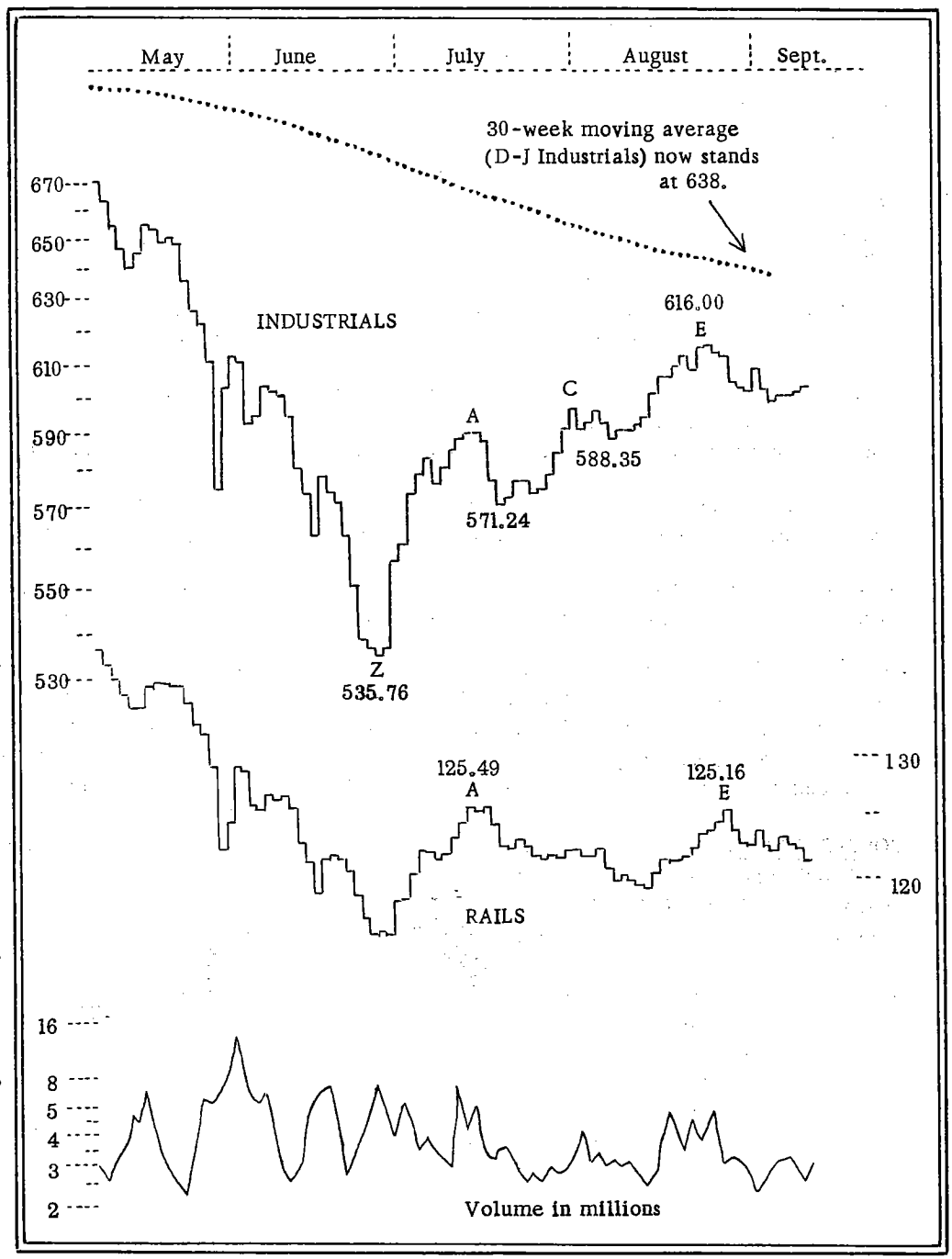
Registered with the Securities and Exchange Commission

THE MARKET The last Letter (192) drew parallels between the recent action and that of 1960-61. During the five months from October, 1960 (the bottom) to March, 1961, the market provided a picture of impressive upside action. However, in March, 1961, the Rail Average recorded a peak. In May the advance-decline ratio "topped out." These phenomena were followed by seven confusing months of divergences, "out-of-gear" movements and erratic volume prior to the final collapse of 1962. Odd-lotters stayed on the selling side of the market throughout most of 1961, which served to keep the bulls happy (although it should be pointed out that the changes in odd-lot sentiment provide important signals -- not the levels of odd-lot buying or selling).

In the current situation, the impressive upside action was confined to the eleven trading days between June 26 and July 12. On July 12 Rails recorded their peak (125.49). On August 23 Industrials struck a recovery high of 616.00. Then as Rails rallied in a belated attempt to better their July 12 high, Industrials "spoiled the broth" by diverging (turning down). The market has retreated since then, although volume has been conspicuously absent (so far) on declining days. In early August odd-lotters switched to the selling side of the market -- but since mid-August there has been little change in odd-lot sentiment.

In Letter 192 I stated that "the secondary trend is probably in the process of turning down." Because of this, a few subscribers are probably conjuring up visions of an immediate "crash" to new lows. While such may be the case, readers should remember that the severe declines of the past few years were preceded by periods of "protracted confusion." Thus "a double top" in Industrials with successive non-confirmations by Rails and the advance-decline ratio proved the forerunner of the 1960 slide. The 1962 collapse was heralded by an extended period of Rail divergence, an early top on the advance-decline ratio, and a final unconfirmed high by Industrials.

In the current situation, the Rails and the advance-decline ratio may have



 recorded their recovery peaks. Nevertheless, it would not surprise me to see a new unconfirmed high in the Industrial Average -- and a general extension of the out-of-gear movement which has been in effect since July 12, 1962.

The stocks in the D-J Industrial Average represent companies which have consistently outperformed the great majority of American corporations from the standpoint of sales, profits, and the prices which their securities command on Wall Street. Moreover, the D-J Industrial Average has, itself, maintained an aura of glamour far surpassing any other stock index. Perhaps because of these factors, the Industrial Average has been the leader on all major rises of recent years. In almost every case, where trouble was forthcoming, the Rails and the advance-decline ratio refused to confirm successive highs in the Industrial Average.

Industrials struck an unconfirmed recovery high on August 23. Since then, they have traced a minor downward zig-zag, but selling pressure (as of this writing) has not been forthcoming. If the market is ready to slide, I would expect weakness to appear this week.

Barring an almost immediate in-gear drop by Industrials, Rails, and the advance-decline ratio, this writer suggests that subscribers sit back and exercise patience in the face of a probable series of divergences, non-confirmations, and unprofitable movements.

AN UNPRECEDENTED SITUATION The great bull market started in June, 1949. As early as 1955 two of the stocks in the D-J Industrial Average recorded their peaks (Swift and Chrysler). During 1956 four Dow stocks hit their bull market highs (Anaconda, Int. paper, Alcoa, United Aircraft). In 1957 Standard of Jersey struck its peak. Amer. Can hit its high in 1958. 1959 saw nine Dow stocks hit their highs. Three more hit their peaks in 1960. Nine Dow stocks established highs in 1961. Texaco was the lone Dow stock to touch a 1962 high.

If we assume that the period of 1955 to 1962 was one of broad distribution for the Dow stocks, it is also interesting to note that not all the Dow stocks struck post-1955 lows together. In fact, on the 1962 collapse only one-third of the Dow stocks recorded lows for the 1955-62 period.

The individual collapses have, in many cases, been subtle and rather gradual. Of the thirty Dow stocks, the following percentage losses have been sustained (at some time) during the period since 1956. Four of the stocks lost over 60% of their value subsequent to their bull market highs, two lost over 50% of their value, fourteen lost over 40% of their value, seven lost over 30% of their value, the rest lost better than 20% with the lone exception of Standard of Calif. which lost 19% of its value.

This prolonged collapse is remarkable. Commenting upon these figures, James Hughes of New York states: "There has never been anything exactly like this in past history so that there appears to be some justification for being sceptical about an old-fashioned forty to sixty per cent decline in the Average to complete a major bear market."

In other words, Hughes is suggesting that since the great majority of Dow stocks have sustained major corrections since their bull market highs, perhaps a case can be made for the bear market's now being completed.

Moreover (see Letter 190) there is no doubt that the great mass of stocks (other than Dow stocks) sustained severe losses during the 1962 decline. Do these factors suggest that the worst may have already been seen?

While not professing to know "the answer", I still fall back on the thesis that following a severe collapse and following a crash, the odds (based on past history) favor something resembling an identifiable major bear market bottom -- with accompanying yields and values. If the area of June-July, 1962 was such a base, this writer failed to see it. Moreover, nothing in the action, the accompanying psychology or the "value" basis of the 1962 low area, jibes with my notion of what a true bear market bottom should look like. A further commentary on this situation appears in the next section.

POST-CRASH ACTION What is a market "crash?" To the best of my knowledge, no one has ever offered a precise definition of this rather rare phenomenon. To my way of thinking, a crash is a violent market break accompanied by (1) a psychology which can best be described as "demoralized", (2) heavy offerings and a decided lack of bids, (3) extraordinary volume or volume which is disproportionately large when compared with average volume preceding the crash.

Under this general definition, the market action of late May, 1962, would fit into the crash catagory. While it is impossible to fully recreate the psychology and "feel" of periods long past, I have carefully studied the daily action of the Averages and volume through all bear markets since 1899. In the majority of cases, each bear market (at some point) provided action which would fit into our definition of a crash. In the majority of cases, these crashes came in the first half of the bear market rather than in the second half. In almost all cases, the crash action and the action immediately thereafter did not mark the termination of the bear market. Statistics for former bear markets are tabulated on page three.

Duration of bear market	Date of actual "crash"	Date of final bear market low	Time elapsed between crash and final bear market low
1899-1900	Dec., 1899	June, 1900	6 months
1902-1903	Nov. 1902	Sept., 1903	10 months
1906-1907	Mar., 1907	Nov., 1907	8 months
1909-1910	Feb., 1910	July, 1910	5 months
1912-1914	June, 1913	Dec., 1914	18 months
1916-1917	Dec., 1916	Dec., 1917	12 months
1919-1921	Feb., 1920	June, 1921	16 months
1929-1932	Oct., 1929	July, 1932	33 months
1937-1938	Sept., 1937	March, 1938	6 months
1939-1942	May, 1940	April, 1942	23 months
1946-1947	Aug., 1946	May, 1947	9 months

Average time elapsed between crash and final bear market lows .....11 months.

In the stock market we must always deal with probabilities -- there are (unfortunately) no absolute certainties. However, the tabulations above suggest that the first crash in a bear market will probably be followed by lower prices, and that the final bear market lows will probably not occur for some time to come (at least 11 months after the initial crash, as far as the average of past performances is concerned).

In view of this and in view of the fact that little more than two months has elapsed since the 1962 crash, it is interesting to study the various comments that are now emanating from Wall Street offices. Perhaps a majority of analysts have turned bullish, and a number of soothsayers are now publicly stating that the bear market is over. While the bullish analysts may be correct (anything can happen), I feel that they can only be correct for the wrong reasons. They may be "right" in the same manner as the man who puts his money on the "30" of a roulette wheel -- and wins.

Perhaps the wisest advice at this juncture appears in Humphrey Neill's latest Letter of Contrary Opinion. "It strikes me as not only prudent, but smart strategy in financial planning, to be opposed to all forecasting at this Labor-Day juncture. A contrary appraisal of current opinions and politico-economics calls for a continued program of preservation, in my view. Surely, when you endeavor to draw up a balance of probabilities today - and puzzle over the Cold War conundrum and check our recommended reading references - you will concur in the policy of trying to HANG ON TO WHAT YOU HAVE in this speculative era."

SUNDRY NOTES Subscribers should watch the daily new lows. Gradual expansion of new lows in 1961 (see Letters 158, 166) was one of the early tip-offs of increasing weakness. The 23 and 24 new lows of September 7 and 10, 1962 were the highest in a month. A trend of expanding new lows is often a sign of technical weakness.

My friend Iain Fraser of 159 Bay St., Toronto 1, Canada is now putting out excellent weekly charts of leading stocks in Great Britain and the Common Market. Perusing the pages of this monthly booklet is fascinating. Most foreign stocks have been hit badly over the past year, far worse than is suggested by the declining foreign stock averages. For instance, the mighty Deutsche Bank is down from 88 marks (1961 high) to a recent 40. Volkswagenwerk, which had investors lined up to buy its new shares, has dropped from a 1961 high of 93 marks to a recent price of 46 marks. The European stock deflation can only be fully grasped through a study of many dozens of charts.

Mr. Eliot Janeway of New York (an economist who is immune from political "baloney"), offers the following predictions for the coming year. (1) Government cuts in spending -- but no tax cuts. (2) Foreign competition and price cutting on a scale hitherto unseen. (3) A continuation of the slide in wholesale prices. (4) A step-up in the Russian oil offensive.

STOCKS Thirty-four out of 346 representative stocks are now holding above their 30-week moving averages, an improvement of four since the last Letter. This means that only 10% of all stocks are above their long-term trend -- a bearish statistic.

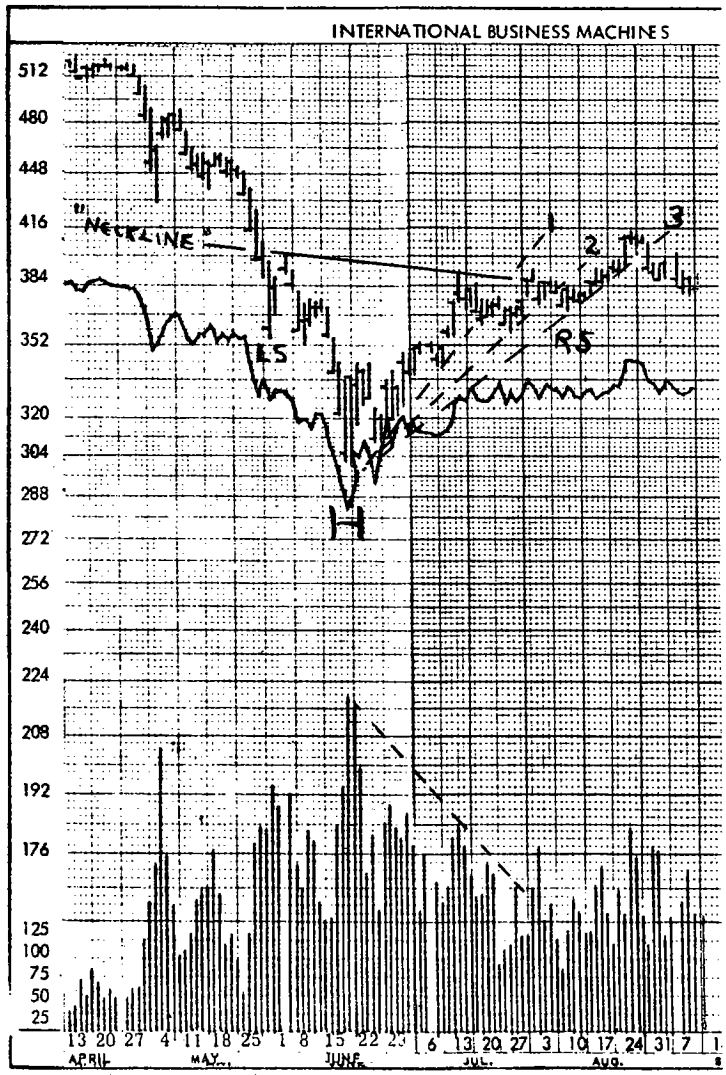
Letter 192 discussed one of the formations which characteristically appears during secondary (upward) movements against a primary bear trend -- "the wedge." As stated in Letter 192, the breaking of the lower trendline in a rising wedge often signals the end of an intermediate rise in a bear market.

A second pattern which may be of real use in gauging the termination of a rally in a bear market is "the fanline" formation. Many stocks record successive upward thrusts during a bear market rally, but these thrusts usually show diminishing strength. The fanline pattern can aid in identifying the area in which diminishing upward thrusts have exhausted their lifting power (at which time a reversal takes place). From past experience, we know that a breaking of the third fanline usually signals a reversal

from a secondary uptrend to a resumption of the primary downtrend.

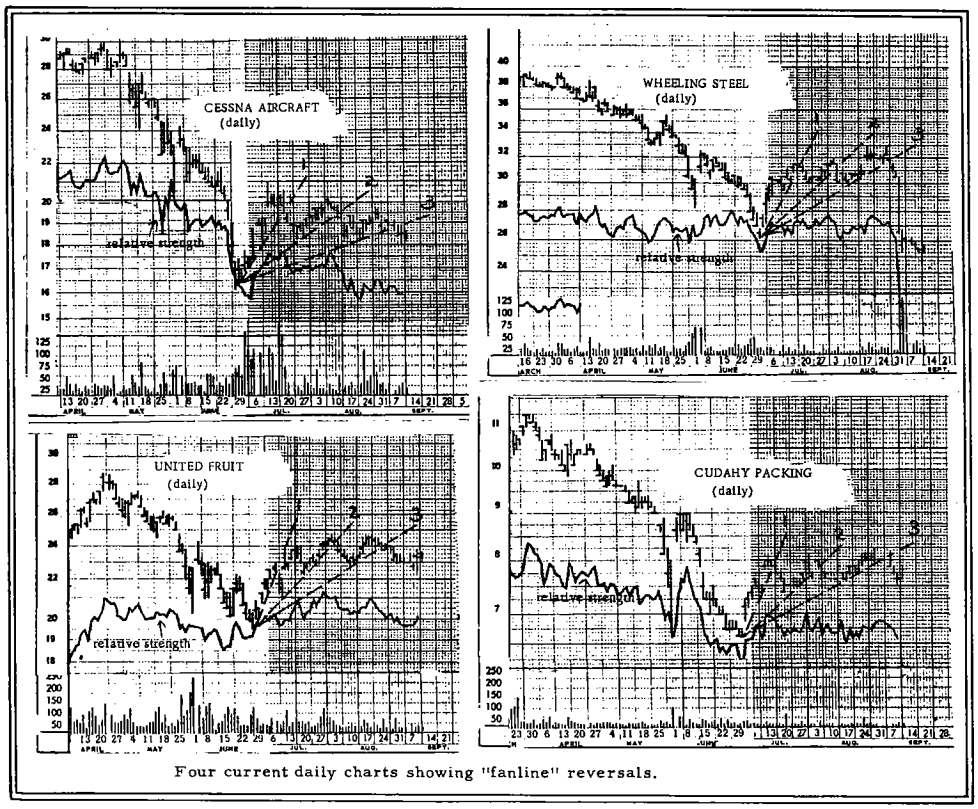
I include four current daily charts representing four issues that have reversed under the fanline principle. Note the manner in which the penetration of the 3rd fanline in Wheeling Steel preceded the news of the dividend cut and the resultant violent drop to new lows.

I. B. M. has become one of the most carefully watched "bellweathers" on the N. Y. Stock Exchange (note the similarity of I. B. M. 's pattern and the pattern of Industrials on page 1). For this reason, the stock is worth scrutinizing at this time. I. B. M. formed a head-and-shoulder reversal pattern between early June and mid-August, 1962. But note the decline in volume from the head (H) to the right shoulder (RS). This volume pattern was unsatisfactory, and I quote from Edwards & Magee ("Technical Analysis of Stock Trends"): "Do not trust or make trading purchases on a head-and-shoulders bottom in which activity does not plainly increase on the advance from the head to the neckline, and does not again pick up noticibly on the rise from the right shoulder through the neckline." Volume did pick up in I. B. M. on the August penetration of the neckline, but after a weak upward push, the volume dwindled, and I. B. M. "flopped" back again. During the rise from the head (H) to the August high, a minor fanline pattern was formed. If the rise in I. B. M. had been a truly strong one, I am convinced that the 3rd fanline would not have been penetrated. In other words, I. B. M. should have continued to rally above the 3rd fanline instead of immediately running out of steam.



I have analyzed I. B. M. in detail because I want to show the difficulty of the current chart picture. If I. B. M. (the leading institutional holding) cannot develop an impressive uptrend, one asks, what can we think of the whole market? To this writer, the I. B. M. price-volume pattern appears subtly suspicious. I would not short the stock -- but I would not own it. This, I might add, is about the way I feel about the market.

LATE NOTES As this is written (Wed., Sept. 12, 12 noon, N. Y. time) the market is in the throes of the fourth consecutive day of divergence (Industrials up, Rails down). In such situations the near-term trend will usually resolve itself sharply in the direction of the first "in gear" movement. Rails and Industrials have not agreed since July 12 -- Therefore, classification of the secondary and minor trend is difficult. The primary trend is bearish, the secondary trend is probably in the process of turning down, the minor trend is obscure.



Four current daily charts showing "fanline" reversals.

Charts on this page courtesy of Traders Research, Inc., P. O. Box 2644, St. Louis 16, Mo.